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HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1953.

No. 445.

In the Matter of

KRIEGER STEEL SECTIONS, INC.,

Bankrupt.

J. WOLFE CHASSEN, as Trustee in Bankruptcy of KRIEGER STEEL SECTIONS, INC.,

Petitioner,

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BENJAMIN WEINTRAUB,
Attorney for Petitioner, J. Wolfe Chassen, as Trustee in Bankruptcy of Krieger Steel Sections, Inc.

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Of Counsel.

THE COURT PRESS, N. Y. C.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of J. Wolfe Chassen prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above cause on the 4th day of September, 1953 (R. 68), affirming the order of the District Court of the United States for the Eastern District of New York dated March 4th, 1952 (R. 59). The order of the District Court dismisses the petition to review the order of Referee Castellano and affirms his order (R. 53-54).

Opinions Below

The opinion of the Court of Appeals for the Second Circuit (R. 65) affirmed the order of the District Court (R. 59). The opinion of the District Court (R. 56-58) is reported in 103 Fed. Supp. 351; it affirmed the order of the Referee (R. 52-53) and directed the trustee in bankruptcy to pay the Collector of Internal Revenue the sum of $24,383.71 out of the fund of $35,373.43 in accordance with his opinion (R. 46-52).

Jurisdiction

The judgment of the United States Court of Appeals was entered on September 4th, 1953.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code (28 U. S. C. 1254), namely, that there is a conflict between the Second and Third Circuit Courts in the interpretation of 11 U. S. C. Chap. 7, Sec. 108 (Sec. 68a of the Bankruptcy Act).

Questions Presented

On February 8th, 1950, the Commissioner of Internal Revenue paid, by six checks, $35,373.43 to the trustee (R. 47). The payment represented interest on over-assessments made by the Collector against the bankrupt. At the time of the payment, there were unpaid taxes due the United States from the bankrupt estate of $24,383.71, for which the United States had already filed a claim with the Referee (R. 39-41).

On March 14th, 1951, as this estate was about to be wound up, the trustee, at the Referee's request, petitioned the Court for an order on notice to all interested parties, directing distribution of the bankrupt's assets pursuant to Title 11 U. S. C. Chap. 7, Sec. 104 (Sec. 64a of the Bankruptcy Act) (R. 3-6). The Petition of the trustee was supported by the State of New York, the City of New York and Messrs. Funk & White, attorneys, who claimed a lien of $7,500 on the interest payment, which, in part, was secured through their efforts.

At this point, the United States, alone and for the first time, contested the right of the trustee to make distribution pursuant to Section 64a of the Bankruptcy Act. The United States claimed, notwithstanding the filing and allowance of its claim, sworn to by the Collector for the First District, that the interest payment it had made was the result of a clerical error committed by the employees of the Bureau of Internal Revenue and was improper to the extent that it had not availed itself of the offset; it insisted on its right to be reimbursed for unpaid taxes, to wit, $24,383.71, before any distribution of the bankrupt's assets took place.

Since the monies in the estate are insufficient to pay all taxing authorities, the tax claim of the United States will be paid in full as against pro rata distribution to other tax claimants, if the United States prevails.

The Referee in directing payment by the trustee cited three cases (R. 51) all dealing with the right of the United States to collect payments erroneously made which were not owing to the taxpayer in the

first instance and are in contradistinction to the case at bar where the interest was due and owing at all times.

On review of the Referee's decision, the District Judge conceded that a creditor could waive his right of setoff against a bankrupt estate. But when the creditor is the United States, the Judge expressed the conviction that: "I have always believed it was horn-book law that the sovereign cannot lose its rights by estoppel or by waiver" (R. 58). No cases were cited in support of this sweeping generalization.

On appeal to the Court of Appeals, that Court then held that the decision did not turn, as the Referee and the District Court indicated, upon the fact that the United States was the claimant (Opinion, R. 66) but upon the right of any creditor to amend his claim timely.

The questions thereby presented are:

1. Did the Commissioner of Internal Revenue by making the payment of $35,373.43 to the trustee waive his right of setoff under 11 U. S. C. Chap. 7, Sec. 108 (Sec. 68a of the Bankruptcy Act)?

2. Is the right of setoff under 11 U. S. C. Chap. 7, Sec. 108 (Sec. 68a of the Bankruptcy Act) self-executing or can it be waived?

3. Is the decision of the Second Circuit in this case in conflict with the decision of the Third Circuit, *In re Mauch Chunk Brewing Co.*, 131 F. (2d) 48?

Statement

The adjudication in bankruptcy occurred on March 23rd, 1949. On May 10th, 1949, the United States filed a claim for taxes in the amount of approximately $246,000. There was then owing only $24,383.71 and an amended proof for that sum was filed on October 30th, 1950. On February 8th, 1950, the Commissioner of Internal Revenue paid by six checks the overassessment.

The claim was sworn to by the Collector of Interal Revenue of the First District and was in the form prescribed by 11 U. S. C. Chap. 6, Sec. 93 (Sec. 57 of the Bankruptcy Act) and General Order No. 21 of this Court, as a guide for all creditors including taxing authorities. The Collector alleged in this claim:

> "1. That he is a *duly authorized agent* for the United States in this behalf and that the above named bankrupt is justly and truly indebted to the United States for lawful Internal Revenue taxes in the sum of $24,383.71. . . ." (Italics ours.)
>
> "2. That no part of said debt has been paid but that the same is now due and payable. . . .
>
> "3. That *there are no set-offs or counterclaims to said* debt . . ." (Italics ours.)
>
> "4. That said debt has priority, and must be paid in full in advance of distribution to creditors, as to the extent provided in §64 or §659 of the Bankruptcy Act; §3466 of the Revised Statutes. . . ."

The filing of this claim, when the United States could have availed itself of the offset, constituted a waiver of the provisions of 11 U. S. C. Chap. 7, Sec. 108 (Sec. 68a of the Bankruptcy Act).

Statute Involved

11 U. S. C. Chap 7, Sec. 108 (Sec. 68a of the Bankruptcy Act) reads as follows:

> "In all cases of mutual debt or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

Specifications of Error to Be Urged

The Courts below erred:

1. In failing to find that the United States by making the payment of $35,373.43, when it already had filed a proof of claim as aforementioned, had waived its right to a setoff under 11 U. S. C. Chap. 7, Sec. 108 (Sec. 68a of the Bankruptcy Act).

2. In holding that the right of setoff was self-executing and was not waived by the United States because there was no change of position by the trustee to his detriment.

3. In failing to follow the decision of the Third Circuit of *In re Mauch Chunk Brewing Co.*, 131 F. (2d) 48.

REASONS FOR GRANTING WRIT

I

The Third Circuit has held that the availability of a setoff is a privilege that can be waived.

The Court of Appeals unlike the Referee and the District Court held that the United States insofar as its rights in this proceeding were concerned was like any other creditor; it stated in its opinion (R. 67):

> ". . . The allowance of an amendment in the circumstances does not turn on the fact that the claimant is the United States."

This holding has now reduced the issue to the sole question of whether a setoff is self-executing or a privilege which can be waived. The Third Circuit had resolved this question in *In re Mauch Chunk Brewing Co.*, 131 F. (2d) 48. In that case a bank allowed a Chapter X trustee to withdraw a debtor's funds and redeposit them in a special account. At the time of the withdrawal, money was due the bank from the debtor which alert bank employees might have but did not offset. Subsequently, the error was discovered and the offset attempted. The Court in an opinion by Judge Goodrich ruled that the attempt came too late; the transfer of the funds to the trustee's account waived any privilege of setoff. Said the Court at page 49:

> "Section 68 of the Bankruptcy Act allows a creditor to set off, if certain conditions of that

> section are met, mutual debts existing between him and the debtor. This is a privilege which the creditor may or may not claim. If it is not asserted, it is lost.[6] Likewise if the creditor's conduct is inconsistent with a subsequent claim of set-off, he is held to have waived it. . . .
>
> [6] *Cumberland Glass Manufacturing Co.* v. *DeWitt & Company,* 1915, 237 U. S. 447, 35 S. Ct. 636, 59 L. Ed. 1042."

In the *Cumberland* case, *supra,* at page 475, this Court stated:

> "The provision (11 U. S. C. Chap. 7, Sec. 108 (Sec. 68a of the Bankruptcy Act)) is permissive rather than mandatory, and does not enlarge the doctrine of set-off, and cannot be invoked in cases where the general principles of set-off would not justify it. . . ." (Parenthetical matter added.)

In the *Mauch Chunk Brewing Co.* case, *supra,* p. 7, no prejudice was shown and yet the right of setoff was deemed lost because it was not availed of promptly. It follows that the determining factor is not prejudice as indicated by the Court of Appeals below, but privilege as set forth in the *Mauch Chunk* and *Cumberland* cases.

In 4 Collier on Bankruptcy (14 Ed.) 709, the author comments:

> "A set-off under Section 68 is not automatic or self executing. If benefit is to be had from the provisions of the section it must be invoked at the proper time and in the proper forum, unless it has already been accomplished between the parties themselves."

Again at page 738, the author states:

> "If a creditor proves his claim in bankruptcy without asserting any right of set-off accruing to him, he will generally be deemed to have waived it."

From the foregoing cases and Collier, it is clear that a law of waiver attaches to Section 68 of the Bankruptcy Act. This is readily understandable since a setoff availed of is naught but a preference, and the tenor of the Bankruptcy Act is to preclude preferential treatment of creditors.

If the United States must abide by Section 68 as other creditors do, then it follows that the United States is bound by the law of waiver which limits the operation of Section 68. It is apparent, furthermore, that the conduct of the United States in the present case in every way paralleled the conduct of the bank in the *Mauch Chunk* case, *supra*. For in both cases the facts show that a creditor paid money to a trustee in careless neglect of the initial privilege of setoff. In the *Mauch Chunk* case the payment was held to be a waiver by the creditor bank. There is no reason why waiver should not similarly operate against the United States here.

Both the Referee and District Judge ignored our arguments as to the effect of the *Mauch Chunk* case and in so doing decided erroneously. The Referee found that the money received by the trustee "was not payable to the estate because the outstanding Federal taxes due to the United States at that time must be deducted under the existing rights of the United States;" and, "the only sum payable to the

trustee at the time of payment of refunds for interest was the difference between the computation of interest $35,373.43 and the outstanding taxes due to the United States of $24,383.71, to wit, the sum of $10,989.72" (R. 51).

The finding that taxes "must be deducted" has no warrant. For setoffs are not mandatory or automatic. There is similarly no warrant for the ruling that the only "sum payable to the trustee" was $10,989.72. A distinct obligation of $35,373.43 was legally due the bankrupt estate. The United States has never denied the existence of this debt. The only way the debt could have been reduced was by an overt act of setoff prior to payment. Once payment was made, there were no funds against which the setoff could operate.

The Court of Appeals below, however, recognized the applicability of *In re Mauch Chunk Brewing Co.* by the footnote to its opinion (R. 66, note 2 in part):

> "Insofar as *In re Mauch Chunk Brewing Co.*, 131 F. (2d) 48 (C. A. 3) may be considered *contra*, we disagree with it."

The decision in the instant case is, therefore, in conflict with the decision of the Third Circuit.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for writ of certiorari should be granted to review the order of the Court below.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 445

J. WOLFE CHASSEN, AS TRUSTEE IN BANKRUPTCY OF KRIEGER STEEL SECTIONS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the referee in bankruptcy (R. 46-52) and the opinion of the District Court (R. 56-58) are reported in 103 F. Supp. 351. The opinion of the Court of Appeals (R. 65-67) is reported in 207 F. 2d 83.

JURISDICTION

The judgment of the Court of Appeals was entered on September 4, 1953. (R. 68-70.) The petition for a writ of certiorari was filed on October 28,

1953. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

At a time when the bankrupt estate owed federal taxes in the amount of $24,383.71, for which proof of claim had been filed containing the statement that there were no set-offs or counter-claims, the Commissioner of Internal Revenue forwarded to the trustee in bankruptcy six checks payable to his order totaling $35,373.43, representing interest on overassessments of other federal taxes. This payment was contrary to an established practice of the Bureau of Internal Revenue in bankruptcy cases to offset all outstanding federal taxes against any amount payable to the trustee, and occurred through the inadvertence and mistake of some subordinate who, contrary to instructions, erroneously made payment to the trustee without deducting the amount then due the United States. The proceeds of the checks remain in the possession of the trustees.

The question presented is whether the courts below were correct in directing the trustee to pay to the United States $24,383.71 out of the $35,373.43, and that upon payment being made the proof of claim by the United States be expunged and disallowed.

STATUTE INVOLVED

Bankruptcy Act, c. 541, 30 Stat. 544:

> Sec. 68. *Set-Offs and Counterclaims*—a. In all cases of mutual debts or mutual credits be-

tween the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.

(11 U.S.C. 1946 ed., Sec. 108.)

STATEMENT

The facts are substantially not in dispute. Based upon oral and written evidence adduced at hearings (R. 50), the referee made the following fact findings, which the District Court approved as amply supported by the evidence (R. 57):

Prior to February 8, 1950, taxes in the sum of $24,383.71 (R. 50, 56) were due and owing the United States by the bankrupt, the details of which are reflected in an amended claim filed on October 30, 1950, superseding prior claims filed by the United States in the bankruptcy proceeding (R. 47, 50-51, 56, Trustee's Ex. 2, R. 39-41).[1] The proof of claim stated that there were no set-offs or counterclaims. (R. 66.)

It is an established practice of the Bureau of Internal Revenue in bankruptcy cases to off-set all outstanding federal taxes due the United States against any amount found payable to taxpayer or his trustee in bankruptcy, in accordance with the rights of the United States under existing laws. This practice was not followed in the case at bar.

[1] Krieger Steel Sections, Inc., was adjudicated a bankrupt on March 23, 1949. (R. 1.) On May 10, 1949, the United States had filed a claim for taxes due in excess of $247,000. (R. 47, 50-51, 56.)

The Bureau of Internal Revenue, on or about February 8, 1950, through inadvertence, failed to deduct the amount of taxes then due the United States in the sum of $24,383.71 and erroneously remitted to the trustee the sum of $35,373.43. (R. 51, 56-57.)

This sum of $35,373.43 represented refunds of interest on overassessments and was paid by the Commissioner of Internal Revenue to the trustee in bankruptcy by six checks, drawn by the Treasurer of the United States, payable to the trustee, totaling that amount and which were deposited by the trustee in his trustee's account. The checks were accompanied by letters (being certificates of overassessment), showing that the payments were made for refund of interest on overassessments. (R. 47, 50-51, 56, Trustee's Ex. 1, R. 37-38.)

The sum of $35,373.43, the proceeds of the checks, remains in the possession of the trustee. (R. 50, 56.)

The amount of $35,373.43 was not payable to the bankrupt estate because of the outstanding federal taxes due the United States at the time of this payment on February 8, 1950, and the only sum payable to the trustee at the time of payment of the refunds of interest was the difference between the computation of interest, $35,373,43, and the outstanding taxes due the United States of $24,383.71, namely, the sum of $10,989.72. (R. 51.)

The final account of the trustee filed February 2, 1951, disclosed the receipt and deposit of the six checks, totaling $35,373.43, and examination by the referee of federal tax claims on file showed the

federal tax claim in the sum of $24,383.71. The account further disclosed that the trustee had a cash balance of $54,523.78, including the moneys refunded on February 8, 1950. These facts appearing of record, pursuant to a suggestion by the referee to the attorneys for the trustee, notice was given to the United States attorney under date of March 2, 1951, and also to the State and City of New York, which likewise had filed tax claims, and to parties asserting attorney's liens on the refunds for services rendered prior to the bankruptcy, that refunds had been received by the trustee after the filing of the Government's claim for taxes. (R. 47-48.) The trustees sought an order to determine the rights of the parties in interest as to the funds in his hands including the $35,371.42 paid by the United States at a time when there was due the United States from the bankrupt other amounts for unpaid taxes. (R. 49.)

All these parties appeared at the hearings before the referee commencing March 14, 1951. (R. 46-47, 49.) Funds on hand were insufficient to pay all tax claims in full (R. 48), but were ample to protect the attorneys asserting the lien for any amount the court might determine to be the reasonable value of their services (R. 50). At the hearings before the referee, the parties conceded that prior to the time of payment of the refund, the United States had the right to deduct from the $35,373.43 the amount due for taxes in the sum of $24,383.71 and remit the balance, but contended that after payment was made the United States waived

the right to set-off the amount due it for taxes. (R. 49.)

On the other hand, the United States urged that the payments to the estate as refunds for interest on overassessments were erroneous payments, and sought to recover from the trustee out of the refund an amount equal to the amount of its amended proof of claim for taxes, namely, $24,383.71. (R. 49.)

The referee concluded that the trustee should repay the $24,383.71 to the Collector of Internal Revenue, and that upon this payment having been made the proof of claim filed on behalf of the United States should be expunged and disallowed (R. 51-52, 57), and made an order to that effect (R. 52-53).

The trustee and the attorneys claiming a lien alone petitioned the District Court for review of the referee's order. (R. 2.) The District Court affirmed the referee's order (R. 59), holding in its opinion that the right of the Government to taxes could not be waived by the inadvertent action of a subordinate in the Bureau of Internal Revenue (R. 56-58).

Upon appeal by the trustee only (R. 2-3, 60-61), the court below affirmed and in an opinion concurred in by two of the judges (Judge Clark concurring in the result), held that the statement by the Government in March, 1951, of the actual facts with respect to its tax claim and the set-off was equivalent to a valid amendment of its proof of claim, made after expiration of the statutory period

for filing claims, and the allowance of an amendment in the circumstances did not turn on the fact that the claimant is the United States (R. 66-67).

ARGUMENT

The decision below turns largely on the particular facts of this case, and presents no question calling for further review by this Court.

1. Indisputably no one changed position to his detriment in reliance upon the mistaken payment by the United States or its failure to state the facts with respect to the set-off by way of proof of claim. (R. 66-67.) All parties concede that prior to the payment of the $35,373, the United States had the right to deduct the amount of $24,383, due it for taxes (R. 49), and all also concede that the payment was inadvertent (R. 67). Indeed, "the sole question" which the trustee asserts that his petition here raises is "whether a setoff is self-executing or a privilege which can be waived." (Pet. 7.) But it is well settled that waiver is the intentional relinquishment of a known right. *Bennecke* v. *Insurance Co.*, 105 U. S. 355, 359; *Lehigh Valley R. Co.* v. *Providence Washington Ins. Co.*, 172 Fed. 364, 365 (C. A. 2d); *Clark* v. *West*, 193 N. Y. 349, 360. Since it is clear that the United States did not intend to waive its right of set-off, the court below correctly concluded that the facts in the instant case fail to establish waiver. (R. 57.)

In Section 68a of the Bankruptcy Act, c. 541, 30 Stat. 544, *supra*, pp. 2-3, Congress has specifically

recognized a creditor's right of set-off. A creditor does not lose his set-off right, when through mistake and without ensuing detriment to any person, he has remitted the entire amount of his debt to the bankruptcy trustee instead of only the balance due. *Union Nat. Bank of Chicago* v. *McKey,* 102 Fed. 662 (C.A. 7th); *Gibson* v. *Central Nat. Bank of McKinney,* 171 F. 2d 398, 400 (C.A. 5th); *In re Farmers' & Mechanics' Bank of Rochester,* 13 Fed. 361 (N.D. N.Y.); see also *Bize* v. *Dickason,* 1 Term Reports 285, 286-287 (K.B. 1786); cf. *Cumberland Glass Co.* v. *DeWitt,* 237 U.S. 447, 458-459.

The courts below did not, as the trustee asserts (Pet. 7), treat the set-off as "self-executing"; indeed, before the bankruptcy proceeding was closed or distribution made, the Government invoked the action of the bankruptcy court of equity for adjustment and rectification of the mistake and application of Section 68a. The court below regarded the assertion by the Government in March, 1951, in the bankruptcy court, of its claim for set-off as equivalent to a permissible out-of-time amendment of its proof of claim, falling, *a fortiori,* within the ambit of its recent holding in *Rumsey Mfg. Corp.* v. *United States,* 206 F. 2d 565 (R. 66).[2]

Contrary to the trustee's further contention

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[2] See also *Lewith* v. *Irving Trust Co.,* 67 F. 2d 855, 856 (C.A. 2d); *In re Meade Tool & Die Co.,* 164 F. 2d 228, 230-231 (C.A. 6th); *In re Prindible,* 115 F. 2d 21, 23 (C.A. 3d); *Hartford Accident & Indemnity Co.* v. *Coggin,* 78 F. 471, 477 (C.A. 4th); *Union Nat. Bank of Chicago* v. *McKey supra; In re Myers,* 99 Fed. 691 (D. Ind.); *In re Progressive Wallpaper Corp.,* 240 Fed. 907, 810-811 (N.D.N.Y.).

(Pet. 9), Section 68a involves no preference (*N. Y. County Bank v. Massey,* 192 U.S. 138, 146-147; *Cumberland Glass Co.* v. *DeWitt, supra,* p. 455), and "is grounded on the absurdity of making A pay B when B owes A" (*Studley* v. *Boylston Bank,* 229 U.S. 523, 528). The principle upon which the statute proceeds is that, in case of mutual debts, it is only the balance which is the real sum owing by or to the bankrupt.

2. There is no conflict, as contended by the trustee (Pet. 7-10), with the decision of the Third Circuit in *In re Mauch Chunk Brewing Co.,* 131 F. 2d 48, requiring resolution by this Court. In that case, the Third Circuit seems to have concluded that the particular facts there amounted to an intentional relinquishment of a known right.[3] Here, on the other hand, all concede that the payment of $35,373 to the trustee was unintentional and all concerned, including officers of the court of equity, such as the trustee and referee, could not have failed to recognize that an error had occurred.[4]

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[3] Thus, in the cited case the court said (p. 50):

> With full knowledge of the reorganization proceedings the appellant [bank] manifestly and without apparent reservation did all it possibly could have done to recognize that the trustee held the entire debtor's deposit as trustee for the benefit of the debtor's estate.

[4] Moreover, here, unlike the *Mauch Chunk* case, public money was involved and the Government further contended in the Court of Appeals that (1) a court of equity will not permit the diversion to private uses of public funds received in its custody under such circumstances that its officers are on notice that the payment had been made by mistake. (*City of New York* v. *Rassner,* 127 F. 2d 703 (C.A. 2d); *United States* v. *Roth,* 164 F. 2d 575, 577 (C.A. 2d); *United States* v. *Sampsell,*

CONCLUSION

The decision of the court below is correct, and the petition for a writ of certiorari should be denied.

Respectfully submitted,

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DECEMBER, 1953

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193 F. 2d 154 (C.A. 9th); *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938 (C.A. 6th)); (2) the right of the United States to money payable for taxes cannot be lost through the mistaken action of a subordinate government employee in violation of specific instructions, especially where there is no change of position to any one's detriment. (*Whiteside* v. *United States*, 93 U.S. 247, 257; *Utah Power & Light Co.* v. *United States*. 243 U.S. 389, 408-409; *United States* v. *St. Paul, M. & M. Ry. Co.*, 247 U.S. 310; *Woolner Distilling Co.* v. *United States*, 62 F. 2d 228 (C.A. 7th)).

However, the judges concurring in the opinion below found it unnecessary to pass upon these contentions. (R. 67.)

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